Comments on Congestion Revenue Rights Enhancements

Working Group Meeting #2 – January 28, 2025

Department of Market Monitoring

February 14, 2025

Summary

The Department of Market Monitoring (DMM) appreciates the opportunity to comment on the *Congestion Revenue Rights Enhancements Working Group Meeting #2 – January 28, 2025*.[1] In this working group meeting, the ISO presented an overview of the current congestion revenue rights (CRR) process, and multiple stakeholders presented their perspectives on CRRs.

Common themes in stakeholder comments and presentations include: (1) the potential market benefits of continued access to CRRs as a hedging product, and (2) the need to reconsider the time periods for which CRRs are offered, to better align with changing congestion patterns. Stakeholders also raised other potential issues that could lead to a significant expansion of scope of the CRR enhancements initiative. DMM recommends the ISO keep the scope of the current initiative relatively narrow, and remain focused on the pressing and longstanding issues of CRR auction efficiency. DMM also supports the development of a small number of new CRR products that better align with the hours of commonly observed congestion patterns.

DMM continues to recommend that the ISO develop a CRR auction design based on willing sellers, and that development of such an approach be the top priority for the current congestion revenue rights enhancements initiative.[2] Losses for transmission ratepayers from the current CRR auction are significant and sustained, and ultimately the result of auction clearing based on CRRs that do not reflect the expected value of day-ahead congestion. This occurs under the design from the combination CRRs effectively offered for sale by the ISO at a $0 offer price, and bids to buy such CRRs that can be well below the true expected value of day-ahead congestion. In addition to addressing ratepayer losses resulting from the current CRR auction design, this willing seller design would mitigate several of the largest issues raised by various stakeholders, including: (1) problems encountered by load serving entities (LSEs) in the CRR allocation process; (2) the reduction in hedging benefits caused by the deficit offset charges; and (3) concerns about overall CRR revenue adequacy.

Based on some comments in working group meetings, DMM believes there may be some misunderstandings or mischaracterizations of DMM's willing seller auction proposal with respect to the CRR allocation and auction process. As explained in DMM's prior paper and comments on the willing seller design, the ISO would continue to allocate CRRs to load serving entities and exporters under the

[1] *Congestion Revenue Rights Enhancements, Working Group Meeting #2*, California ISO, January 28, 2025: https://stakeholdercenter.caiso.com/InitiativeDocuments/Presentation-Congestion-Revenue-Rights-Enhancements-Jan-28-2025.pdf

[2] *Willing seller market design for congestion revenue rights,* October 23, 2024, Department of Market Monitoring: https://www.caiso.com/documents/willing-counterparty-whitepaper-oct-23-2024.pdf

current allocation process.[3] Entities that are allocated CRRs in this process could continue to sell (or buy) additional CRRs as willing counterparties in the subsequent willing seller auction for CRRs. Furthermore, as explained in recent DMM comments in this initiative, restrictions placed on CRR allocations, bidding, and payouts in 2019 would be removed. This would increase the ability of LSEs to acquire the CRRs and CRR payments needed to hedge their sources of supply.[4]

Comments

DMM recommends a limited scope for the current CRR enhancements initiative, with development of a CRR auction based on willing sellers as a top priority

In the working group process, stakeholders have introduced a wide range of potential topics to include in the scope of the initiative. For example, some stakeholders have proposed enhancements to transmission outage reporting and modeling in an effort to improve convergence between the CRR model and the day-ahead market, or recommended the establishment of a reservation price for CRRs currently offered by the ISO for sale in the auction at a $0 reservation price. Others have expressed concern about the allocation process, or the diminished hedging value of CRRs in the context of deficit offsets.

DMM recommends keeping the scope of the current CRR enhancements initiative narrow, and prioritizing the development of a CRR auction based on willing sellers. This would be an efficient and reliable solution to the long-standing issue of ratepayer losses from the CRR auction, and would also address numerous other concerns raised by stakeholders. As explained in DMM's previous comments, the willing seller auction design will also address: (1) problems encountered by load serving entities (LSEs) in the CRR allocation process; (2) the reduction in hedging benefits caused by the deficit offset charges; and (3) concerns about overall CRR revenue adequacy.[5] DMM also supports the development of a small number of new CRR products that better align with the hours of commonly observed congestion patterns.

[3] *Willing seller market design for congestion revenue rights,* October 23, 2024, Department of Market Monitoring, pp 11 and 14: https://www.caiso.com/documents/willing-counterparty-whitepaper-oct-23-2024.pdf

[4] *Comments on Congestion Revenue Rights Enhancements Scoping Discussion*, Department of Market Monitoring, December 13, 2024: https://www.caiso.com/documents/dmm-comments-on-congestion-revenue-rights-enhancements-scoping-discussion-nov-14-2024-working-group-dec-13-2024.pdf

[5] Ibid.

DMM does not propose elimination of the CRR allocation or auction

Based on some comments in working group meetings, DMM believes there may be some misunderstandings or mischaracterizations of DMM's willing seller auction proposal with respect to the current CRR allocation and auction process.

- First, DMM's proposal calls for retaining (and improving) the current CRR allocation process. As explained in recent DMM comments in this initiative, restrictions placed to lower transmission limits used in the CRR allocation process in 2019 would be raised, thereby increasing the amount of CRR nominations that would clear in the allocation process. Entities that are allocated CRRs in this process can continue to sell (or buy) additional CRRs as willing counterparties in the subsequent willing seller auction for CRRs.
- Second, DMM does not propose to altogether eliminate the CRR auction. Instead, DMM recommends modifying the current auction so that it only includes offers to sell CRRs from willing counterparties. In other words, this approach simply eliminates the additional CRRs that are essentially offered for sale by the ISO at a $0 offer price under the current approach.

Analysis by DMM shows that even under the current auction, a substantial volume of CRRs are already being offered for sale by willing counterparties that include LSEs (who are reselling a portion of their allocated CRRs), and financial entities submitting bids for CRRs in the counterflow direction of congestion (which clear at negative prices). With the willing seller approach, the ISO acts as a central clearinghouse for trading, and does not intervene to sell additional CRRs backed by congestion revenues that will otherwise be re-allocated back to transmission ratepayers. Analysis by DMM shows that the willing seller design is workable, and can provide an effective and efficient alternative to the current auction design.[6]

The willing seller model will increase the ability to use CRRs as hedges in several ways

In the working group meeting, many stakeholders expressed a strong demand for CRRs as hedges. The willing seller design would allow the ISO to continue facilitating a liquid market for CRRs being bought or sold as hedges, while also addressing numerous other stakeholder concerns that have been raised about the current CRR allocation and auction process.[7]

First, as noted above and explained in recent DMM comments in this initiative, restrictions placed to lower transmission limits used in the CRR allocation process in 2019 would be raised, thereby increasing the amount of CRR nominations that would clear in the allocation process.

Second, since all CRRs sold in the willing seller approach are financially backed by a willing counterparty (rather than out of congestion revenues), the willing seller approach is guaranteed to entirely eliminate ratepayer losses resulting from the current CRR auction design. For the same reason, the willing seller

[6] *Willing seller market design for congestion revenue rights,* October 23, 2024, Department of Market Monitoring: https://www.caiso.com/documents/willing-counterparty-whitepaper-oct-23-2024.pdf

[7] *Comments on Congestion Revenue Rights Enhancements Scoping Discussion*, Department of Market Monitoring, December 13, 2024: https://www.caiso.com/documents/dmm-comments-on-congestion-revenue-rights-enhancements-scoping-discussion-nov-14-2024-working-group-dec-13-2024.pdf

approach would address revenue inadequacy by ensuring ample congestion revenue available to pay allocated CRRs. The pool of congestion revenues available to pay allocated CRRs would no longer be eroded by payouts to auctioned CRRs that lack a counterparty. Consequently, the deficit offset charges that were implemented in 2019 to reduce revenue inadequacy and auction losses can also be eliminated. Eliminating these auction losses and deficit offset charges will allow for full funding of all CRRs provided through the allocation process. Similarly, since all CRRs sold in the auction would be financially backed directly by various counterparties, these CRRs would also be fully funded and not subject to any deficit offset charges.

Third, since all CRRs sold in the willing seller approach are financially backed by a willing counterparty, the restrictions on source/sink combinations that could be bid into the CRR auction that were put in place in 2019 would also be eliminated. This would increase the ability of entities to submit CRR bids to sell hedges directly between the generation, load, and trading hubs that other entities may seek to purchase as hedges.[8]

DMM supports developing a limited number of new CRR products to better align with changing congestion patterns

DMM proposes limiting the scope of the current CRR enhancements initiative to focus on eliminating ratepayer losses from the auction, while maintaining the ability for all participants to buy and sell CRRs. However, DMM also supports the development of a small number of new CRR products that better reflect the hours of changing congestion patterns.

Some stakeholders noted that the traditional peak and off-peak hour CRR products currently available no longer reflect commonly observed congestion patterns for which hedges may be desired. For example, the proliferation of solar generation capacity in the southern portion of the California ISO balancing authority area has created regular south-to-north congestion during the mid-day hours, when solar production peaks.

DMM acknowledges such shifts in congestion patterns and believes there would be value in defining new CRR products that align with these patterns. However, in an effort to contain the scope of this initiative, DMM encourages the ISO to focus only on a small number of new products designed to capture the most prevalent and significant congestion pattern changes.

As described above, under the willing seller auction design, the transmission model in the CRR allocation could be less restrictive and more allocated CRRs could be released. The magnitude of these benefits could be assessed by re-running the CRR model with less restrictive transmission limits. By assessing different scenarios, the ISO could better understand the degree to which transmission limits could be relaxed in the allocation process without creating concerns about too much overall revenue inadequacy. DMM recommends that the ISO seek to perform such analysis as part of this initiative.

[8] Since 2019, entities cannot submit bids to "sell" hedges through counterflow CRRs directly from a load point to a generation node. This restriction would be eliminated under the willing seller approach.

The willing seller design provides the only viable framework for facilitating a market for CRRs to hedge congestion costs in the context of a Western regional day-ahead energy market

The ISO and some stakeholders contend that the ability for hedging of day-ahead congestion costs through CRRs are critical for efficient forward contracting of energy, open access to transmission, and development of new supply resources. However, neither the ISO's extended day-ahead market (EDAM) design or the Markets+ design include any provisions for the sale of CRRs to facilitate hedging of regional day-ahead market congestion costs.

Given the significant losses to transmission ratepayers incurred under the ISO's current CRR auction design, DMM understands why entities that own or control transmission rights would not want to adopt the ISO current auction design as part of a regional day-ahead market. However, this raises the question of why the current CRR auction is needed for the CAISO footprint, but not for a broader regional day-ahead market.

The willing seller auction design provides a viable framework for facilitating the market for CRRs to hedge congestion costs in the context of a Western regional day-ahead energy market, without requiring that entities that own or control the transmission rights needed to form such a regional market to incur losses from the sale of CRRs by the ISO, backed by congestion revenues. Under the willing seller approach:

- A process can first be used to *allocate* CRRs to transmission owners and load serving entities that pay for the cost of transmission.
- After this *allocation* process, the ISO could then operate a market in which all entities would be free to seek to buy or sell CRRs to other entities based on prices that reflect the actual expected day-ahead market congestion costs and the value that CRRs provide against the risk associated with these costs to different market participants.

This approach ensures that congestion revenues are allocated to transmission owners and load serving entities that pay for the cost of transmission. A market is then run based on sales of CRRs only by willing sellers who serve as the financial counterparty to these CRRs, so that these CRRs are not backed by congestion revenues from the day-ahead market.